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DEPARTMENT OF STATE

AIRGRAM

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DATE: July 15, 1971

TO : Department of State

INFO : BENGHAZI, LONDON, ROME

DEPT PASS: ALGIERS, BEIRUT, CARACAS, JIDDA, KUWAIT, LAGOS, TEHRAN

FROM : Amembassy TRIPOLI

SUBJECT : Agreement Reached on Cost Oil for Libya

REF :

JUL 20 AM 11:12 FBI 4 23 DEPARTMENT OF STATE

Among the peripheral benefits won by the LARG in negotiations with the oil industry last spring was a commitment by the producing companies to supply crude oil at cost plus a fee to the Libyan National Oil Company (LNOC) for processing and consumption within Libya. Negotiations to implement this provision of the 1971 agreement began in April and were completed at the end of June. The Embassy understands that signature of a supplementary agreement on cost oil has now been signed by each of the producing companies. The supplementary arrangements were negotiated by an industry committee and technical representatives of the Ministry of Petroleum and LNOC.

The negotiations focused on three points:

a) the amount of oil to be delivered,
b) the amount of the fee to be paid by LNOC,
c) the refining arrangements envisaged by LNOC--which were based upon a processing contract it had concluded earlier this year with the Societa Industriale Catonese (Sincat) refinery at Priolo, Sicily.

The latter point proved the most difficult to overcome.

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Contents and Classification Approved by: ECON:APlacke

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The LNOC-Sincat processing agreement provided for refining up to 20,000 b/d of Libyan oil. LNOC would lift the processed gasoline, diesel and some of the kerosene for marketing in Libya and trade to Sincat the excess products--mainly naphtha and fuel oil--against the cost of processing. Since the 1971 agreement between the LARG and the oil companies specifically provided that oil made available at cost would be refined in Libya, the companies balked at the LNOC-Sincat arrangements. The companies argued that, under this arrangement, they would be supplying cost oil to a competitor.

Ultimately, a compromise formula was developed under which the companies have agreed to supply to LNOC, on a production pro-rata basis, up to 20,000 b/d of crude oil. However only seventy per cent of the oil is to be invoiced at cost plus a 5 cent/b fee--on the assumption that about this proportion will be returned to Libya for domestic consumption. The remainder will be invoiced as a royalty oil entitlement at the posted price, on the assumption that this is about the proportion LNOC will trade to the refiner or would export if refining were done at its own plant now under construction and scheduled for completion in 1973.

COMMENT: The companies have not done badly under this arrangement. There was considerable discussion about both the quantity limitation and the size of their fee, but once the basic conflict over refining abroad was resolved, LNOC agreed to the 5 cent fee (it had at first insisted upon one cent only) and accepted a limit of 20,000 b/d (the companies had begun by offering only 15,000 b/d and LNOC had rejected any limit.) The companies will receive, on the average, about $1.61/b for the 70 per cent supplied at a tax paid cost of about $2.00/b. They will receive about $1.02 for the 30 per cent supplied at a current average posting of about $3.40. This, plus the 2¼ cents/b after tax earnings from the 5 cent surcharge, yields net average payments by LNOC for "cost" oil of about $2.65 per barrel--which is within the range of current realized (or market) prices for Libyan crude.

The Embassy understands that the present cost oil arrangement is to run concurrently with the five-year financial agreement which it supplements. The 12,000 b/d of oil products which could be refined for domestic consumption under this arrangement (plus the 9,000 b/d available from an Esso refinery) is more than sufficient to meet Libya's projected demand for 1975 and beyond.

PALMER